Supreme Court, U.S.
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No. 92-756

In The

Supreme Court of the United States

October Term, 1992

In Re: VICON RECOVERY SYSTEMS, INC. a/k/a VICON RECOVERY SYSTEMS, INC. OF VERMONT, VICON RECOVERY SYSTEMS OF MANCHESTER, INC., VICON RECOVERY SYSTEMS OF MASSACHUSETTS, INC., VICON RECOVERY SYSTEMS OF VERMONT, INC. and VICON RECOVERY SYSTEMS OF WEBSTER, INC.,

Debtors.

CITY OF RUTLAND AND TOWN OF BRISTOL, VERMONT,

Petitioners,

vs.

THE INDUSTRIAL BANK OF JAPAN, LTD., NEW YORK BRANCH and THE INDUSTRIAL BANK OF JAPAN TRUST COMPANY,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether the Third Circuit Court of Appeals erred in applying and interpreting the provisions of 11 U.S.C. § 724(b) so as to raise a substantial question as to the proper distribution of proceeds of the sale of real property, in which the bankruptcy estate did not have an interest, to a mortgagee in a Chapter 7 proceeding in sharp conflict with the Fourth Circuit's decision in *Maryland National Bank v. Mayor & City Council of Baltimore*, 723 F.2d 1138 (4th Cir. 1983); with the Second Circuit's in *In re Parr Meadows Racing Ass'n, Inc.*, 880 F.2d 1540 (2d Cir. 1989), *cert. denied*, 493 U.S. 1058 (1990); and the Third Circuit's in *Equibank, N.A. v. Wheeling-Pittsburgh Steel Corp.*, 884 F.2d 80 (3d Cir. 1989)?

2. Whether the Third Circuit Court of Appeals erred in holding that the secured pre-petition municipal tax liens of the City of Rutland and Town of Bristol, Vermont should not be given priority in distribution over the claims of the Industrial Bank of Japan Limited, New York Branch, and the Industrial Bank of Japan Trust Company as mortgagees?

3. Whether the Third Circuit Court of Appeals erred in holding that secured pre-petition municipal tax liens of the City of Rutland and Town of Bristol, Vermont should not be paid by the secured creditor from the proceeds of the sale of the mortgaged property, thus, allowing the mortgagees to avoid payment of the perfected municipal tax liens?

4. Whether the Third Circuit Court of Appeals erred in holding that certain municipal tax claims of the City of Rutland and Town of Bristol, Vermont had not attained lien status pursuant to state law and were not payable by the secured creditors as payment for benefit received in accordance with 11 U.S.C. § 506?

LIST OF PARTIES AND RULE 29.1 LIST

The parties who appeared before the Third Circuit Court of Appeals in this proceeding are:

The City of Rutland, Vermont, Appellant/Petitioner;*

The Town of Bristol, Vermont, Appellant/Petitioner;*

The Industrial Bank of Japan, Ltd., New York Branch, Appellee/Respondent; and

The Industrial Bank of Japan Trust Company, Appellee/ Respondent.

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* Petitioners have no parent companies, subsidiaries or affiliates to list pursuant to Rule 29.1.

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No.

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In Re: VICON RECOVERY SYSTEMS, INC. a/k/a VICON RECOVERY SYSTEMS, INC. OF VERMONT, VICON RECOVERY SYSTEMS OF MANCHESTER, INC., VICON RECOVERY SYSTEMS OF MASSACHUSETTS, INC., VICON RECOVERY SYSTEMS OF VERMONT, INC., and VICON RECOVERY SYSTEMS OF WEBSTER, INC.,

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CITY OF RUTLAND AND TOWN OF BRISTOL, VERMONT,

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THE INDUSTRIAL BANK OF JAPAN, LTD., NEW YORK BRANCH and THE INDUSTRIAL BANK OF JAPAN TRUST COMPANY,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

PETITION FOR A WRIT OF CERTIORARI

The Petitioners, the City of Rutland and Town of Bristol, Vermont, respectfully pray that a Writ of Certiorari issue to review the Judgment Order of the United States Court of Appeals for the Third Circuit entered in the above-entitled proceeding on August 6, 1992.

OPINIONS BELOW

The Judgment Order of the United States Court of Appeals for the Third Circuit has not been reported. It is reprinted in the Appendix hereto, p. 28a, *infra*.

The Opinion and Order of the United States District Court for the District of New Jersey (Hon. Maryanne Trump Barry, U.S.D.J.) have not been reported. They are reprinted in the Appendix hereto, p. 10a, *infra*.

The Opinion and Order of Distribution on Remand of the United States Bankruptcy Court for the District of New Jersey (Hon. William F. Tuohey, U.S.B.J.) have not been reported. They are reprinted in the Appendix hereto, p. 22a, *infra*.

The Opinion and Order of the United States Bankruptcy Court for the District of New Jersey (Hon. William F. Tuohey, U.S.B.J.) have not been reported. They are reprinted in the Appendix hereto, p. 1a, *infra*.

STATEMENT OF JURISDICTION

Invoking the jurisdiction of the United States Bankruptcy Court as this is a core proceeding relating to distribution of property of the estate and estate administration under 28 U.S.C. §§ 1334 and 157 (b) (2) (A), (K) and (O), Petitioners brought this suit in the United States Bankruptcy Court for the District of New Jersey. On April 5, 1991, the United States Bankruptcy Court for the District of New Jersey granted Petitioners' motion to allocate

and distribute proceeds of the debtors' improved and unimproved real estate and personal property. *See* p. 8a, *infra.*

On Respondents' appeal, the United States District Court for the District of New Jersey, on November 26, 1991, ordered the Opinion and Order of the United States Bankruptcy Court for the District of New Jersey filed April 5, 1991 reversed in part, affirmed in part, and remanded for further hearings. *See* p. 20a, *infra.* No petition for rehearing was sought.

The United States Bankruptcy Court for the District of New Jersey issued an Opinion and Order of Distribution on Remand on March 5, 1992. *See* p. 22a, *infra.*

On August 6, 1992, the United States Court of Appeals for the Third Circuit affirmed in a Judgment Order the Opinion and Order of the United States District Court for the District of New Jersey. *See* p. 28a, *infra.*

The jurisdiction of this Court to review the Judgment Order of the Third Circuit is invoked under 28 U.S.C. § 1254 (1).

STATUTES INVOLVED

There are two federal statutes which are central to this Petition, 11 U.S.C. § 506 and 11 U.S.C. § 724.

11 U.S.C. § 506

§ 506. Determination of secured status.

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under

section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

(c) The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless —

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

11 U.S.C. § 724

§ 724. Treatment of certain liens.

(a) The trustee may avoid a lien that secures a claim of a kind specified in section 726(a)(4) of this title.

(b) Property in which the estate has an interest and that is subject to a lien that is not avoidable under this title and that secures an allowed claim for a tax, or proceeds of such property, shall be distributed —

(1) first, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is senior to such tax lien;

(2) second, to any holder of a claim of a kind specified in sections 507(a)(1), 507(a)(2), 507(a)(3), 507(a)(4), 507(a)(5), or 507(a)(6) of this title, to the extent of the amount of such allowed tax claim that is secured by such tax lien;

(3) third, to the holder of such tax lien, to any extent that such holder's allowed tax claim that is secured by such tax lien exceeds any amount distributed under paragraph (2) of this subsection;

(4) fourth, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is junior to such tax lien;

(5) fifth, to the holder of such tax lien, to the extent that such holder's allowed claim secured by such tax lien is not paid under paragraph (3) of this subsection; and

(6) sixth, to the estate.

(c) If more than one holder of a claim is entitled to distribution under a particular paragraph of subsection (b) of this section, distribution to such holders under such paragraph shall be in the same order as distribution to such holders would have been other than under this section.

(d) A statutory lien the priority of which is determined in the same manner as the priority of a tax lien under section 6323 of the Internal Revenue Code of 1954 (26 U.S.C. § 6323) shall be treated under subsection (b) of this section the same as if such lien were a tax lien.

STATEMENT OF THE CASE

Municipalities, like all other state and federal governmental institutions, depend upon the assessment and collection of taxes and other charges to fund the essential services provided to their residents. Without the orderly collection of these revenues, the business of government would grind to a halt.

The net result of the United States District Court's decision, affirmed by the Third Circuit Court of Appeals, is to allow a mortgagee, under the guise of the United States Bankruptcy Code, to sell property securing its lien without payment of perfected municipal tax liens. No other law, state or federal, permits such a result. To follow the interpretation of 11 U.S.C. § 724 adopted by the Third Circuit would allow any lender to place into bankruptcy a borrower who did not pay its taxes, thereby permitting avoidance of the taxes.

The City of Rutland and Town of Bristol, Vermont (hereinafter "the Municipalities") maintained that the United States Bankruptcy Code was never intended to allow a court to reach such a result. If the lower court's opinions are allowed to stand, any mortgagee can manipulate the United States Bankruptcy Code so as to avoid the payment of perfected municipal tax liens which in any other context would have to be paid in full.

Vicon Recovery Systems, Inc. a/k/a Vicon Recovery Systems, Inc. of Vermont, Vicon Recovery Systems of Manchester, Inc., Vicon Recovery Systems of Massachusetts, Inc., Vicon Recovery Systems of Vermont, Inc., and Vicon Recovery Systems of Webster, Inc. each filed voluntary petitions for relief pursuant to Chapter 7 of Title 11 of the United States Code, 11 U.S.C. § 701, *et seq.* (hereinafter the "Bankruptcy Code"), on or about August 23, 1988. By order of the United States Bankruptcy Court, the cases were consolidated for administrative purposes. Thereafter, a

Chapter 7 trustee was appointed to provide for the orderly liquidation of the debtors' estates and, on or about August 23, 1989, Jonathan Kohn was appointed as substitute trustee (hereinafter the "Trustee").

Prior to the filing of the Chapter 7 petitions, the debtors owned and operated a massive resource recovery facility in Rutland, Vermont, as well as landfills in Bristol, Vermont. The primary sources of financing for the construction of the facility were the Industrial Bank of Japan, Ltd., New York Branch, and the Industrial Bank of Japan Trust Company (hereinafter, collectively, "IBJ"). Sums advanced by IBJ for this purpose exceeded $36,000,000.00. To secure the repayment of these loan amounts, the debtors granted IBJ a first mortgage on the real property and the improvements thereon. Due to problems associated with cost overruns and ash removal, the facility ceased operations only a short time after operations began.

Despite the fact that the value of the facility was substantially less than IBJ's mortgages by any method of appraisal, IBJ failed to foreclose on the property and, instead, advocated the institution of Chapter 7 proceedings by the debtors. Thereafter, the Trustee did not seek authorization to immediately abandon the facility as having no value for the unsecured creditors of the bankruptcy estates but, rather, at the behest of IBJ, attempted to market the property, without success, for a period of nearly two years. Curiously, while this improvident and expensive course of action was being pursued, IBJ willingly financed the exorbitant costs of administering the facility, including voluntarily advancing legal fees of over $720,000.00. To date, IBJ has advanced approximately $1,186,000.00 to the Trustee and his professionals pursuant to various post-petition financing orders entered by the Bankruptcy Court. It was these expenses of IBJ which the United States Court of Appeals for the Third Circuit held should be paid first, ahead of the Municipalities' perfected pre-petition tax liens.

On or about June 1, 1990, the Trustee entered into an Agreement of Sale and Purchase (hereinafter the "Agreement") with Meridian Group, Inc. (hereinafter "Meridian"). Pursuant to the Agreement, the Trustee proposed to sell, transfer and assign to Meridian certain assets of the debtors' estates, including the Rutland Resource Recovery Facility and the landfills located in Bristol, Vermont, for the sum of $2,800,000.00. The Trustee filed a Notice of Proposed Private Sale dated June 15, 1990 with the Clerk of the United States Bankruptcy Court, which included a Notice of Motion and Application for the issuance of an Order authorizing the private sale of the facility free and clear of liens and encumbrances, including the real estate tax liens, the personal property tax liens and the administrative claims of the City of Rutland and Town of Bristol, Vermont. When the Municipalities objected to the Trustee's application, the Bankruptcy Court approved the sale subject to a further hearing regarding the respective priorities of the claims of the Municipalities and IBJ. The Municipalities' pre-petition claims, including liens, now total more than $720,000.00 while their post-petition administrative claims now total over $688,000.00.

The Municipalities and IBJ filed briefs with the Bankruptcy Court relative to the appropriate distribution of the proceeds of the sale to Meridian, and oral argument was heard thereafter.

On April 5, 1991, The Honorable William F. Tuohey, United States Bankruptcy Judge, issued an Opinion and Order which constituted the court's findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052. Judge Tuohey carefully reviewed the relevant statutory and case authorities, rejected the cases relied upon by IBJ, and concluded that the Municipalities' pre-petition real property municipal tax liens were duly perfected under Vermont law (a finding that was not challenged by IBJ on appeal) and were to be accorded priority over IBJ's claims. In so doing, the Bankruptcy Court determined

that § 724(b) of the United States Bankruptcy Code was inapplicable to the distribution of the sale proceeds, finding that the statute's provisions clearly could not be utilized by a secured creditor to distribute property in which the estate did not have an interest. Judge Tuohey further concluded that, although the Municipalities' claims for post-petition taxes were to be accorded first priority administrative status, no portion thereof was payable by the secured creditor as compensation for benefits received pursuant to § 506 of the United States Bankruptcy Code.

The net effect of Judge Tuohey's decision was that the Municipalities' pre-petition tax liens would be paid. All other expenses, including the legal and other fees incurred and encouraged by IBJ, except the Municipalities' post-petition taxes, would be paid, and the balance of the funds, if any, in the estates were to be paid to IBJ as mortgagee.

IBJ timely appealed to the United States District Court for the District of New Jersey with respect to Judge Tuohey's ruling on the application of 11 U.S.C. § 724(b), and the Municipalities cross-appealed on the 11 U.S.C. § 506(c) issue.

On November 25, 1991, United States District Court Judge Maryanne Trump Barry reversed in part, remanded, and affirmed in part the Opinion and Order of the Honorable William F. Tuohey. Contrary to Judge Tuohey's holding, Judge Barry held that 11 U.S.C. § 724(b) was applicable and could be used by a secured creditor, despite its plain meaning, to distribute property which would never become part of the bankruptcy estates, and served to subordinate the Municipalities' tax liens to IBJ's claims. Judge Barry further ruled that the Municipalities were not entitled to recover on their post-petition tax claims from IBJ pursuant to § 506(c) of the United States Bankruptcy Code. Thus, under Judge Barry's ruling, IBJ would receive from the proceeds of the sale all of the expenses it had improvidently encouraged and paid. In other words, the Municipalities would receive as little as $163,290.00,

while the remainder of the sale proceeds would be turned over to IBJ.

On August 6, 1992, the United States Court of Appeals for the Third Circuit issued a Judgment Order without opinion affirming the Order of the United States District Court for the District of New Jersey.

REASONS FOR GRANTING THE WRIT

I.

THE SECOND, THIRD AND FOURTH CIRCUITS ARE DIVIDED AS TO THE APPLICABILITY AND PROPER INTERPRETATION OF 11 U.S.C. § 724(b).

The Court of Appeals for the Third Circuit, by rendering its Judgment Order in this matter on August 6, 1992, has created, not only an intra-Circuit conflict, *see Equibank, N.A. v. Wheeling-Pittsburgh Steel Corp.*, 884 F.2d 80 (3d Cir. 1989), but also a conflict among the Circuits, *compare In re Parr Meadows Racing Ass'n*, 880 F.2d 1554 (2d Cir. 1989), *cert. denied*, 493 U.S. 1058 (1990), and *Maryland Nat'l Bank v. Mayor & City Council of Baltimore*, 723 F.2d 1138 (4th Cir. 1983), in finding that 11 U.S.C. 724(b) can be used by a mortgagee to avoid the valid pre-bankruptcy municipal tax liens of two Vermont municipalities, Rutland and Bristol. It is submitted that § 724 of the United States Bankruptcy Code was never intended to be used by the secured creditors, The Industrial Bank of Japan, Ltd., New York Branch, and the Industrial Bank of Japan Trust Company, as a means for avoidance of municipal tax liens and repayment of the banks' voluntarily incurred expenses. Indeed, by affirming the Opinion of the Honorable Maryanne Trump Barry, United States District Court for the District of New Jersey, the Third Circuit has given the federal bankruptcy statute involved, 11 U.S.C. § 724(b), an unwarranted construction not supported by another relevant

decision in its own Circuit, as well as the decisions of two other Circuits, and has in effect created an intolerable situation for municipalities as well as for other governmental bodies.

Section 724 of the United States Bankruptcy Code is clear and unequivocal — it applies only to "[p]roperty in which the estate has an interest," not to fully encumbered property in which the estates had no interest and which would render no benefit to the estates' unsecured creditors. This Court has recently been consistent in its application of the "clear meaning" rule, and it is submitted that this directive to lower courts to look to the plain text of the statute was ignored by the Third Circuit. *See, e.g., Patterson v. Shumate*, 60 U.S.L.W. 4550 (June 16, 1992); *Toibb v. Radloff*, 501 U.S. __, 115 L. Ed. 2d 145, 111 S. Ct. __ (1991); *Union Bank v. Wolas*, 502 U.S. __, 116 L. Ed. 2d 514, 112 S. Ct. __ (1991). Indeed, Chapter 7 of the United States Bankruptcy Code contains the provisions peculiar to a liquidation, including a trustee's rights, duties and responsibilities. Nevertheless, the Third Circuit has now allowed secured creditors the benefit of 11 U.S.C. § 724, rather than a trustee.

It is undisputed that the Municipalities' pre-petition tax and associated claims for interest and penalties are secured by valid, perfected liens under Vermont state law. The Bankruptcy Court determined, and the parties do not dispute, that when the petitions for relief under Chapter 7 of the United States Bankruptcy Code were filed in these consolidated cases in August, 1988, the Municipalities had valid, perfected first liens on the property for the municipal taxes due, now in excess of $720,000.00. Nevertheless, IBJ sought to avoid its obligations to the Municipalities by an end run through Chapter 7 of the United States Bankruptcy Code. Judge Tuohey, U.S.B.J., clearly perceived that Chapter 7 and specifically 11 U.S.C. § 724, was not intended to be used for such purposes and correctly ruled that the Municipalities' perfected, pre-petition municipal tax liens were to

be paid first from the proceeds of sale. The law of the Third Circuit was well-settled in this regard. *See Equibank, N.A. v. Wheeling-Pittsburgh Steel Corp.*, 884 F.2d 80, 84-85 (3d Cir. 1989).

Indeed, the bankruptcy of a borrower should not be utilized by a mortgagee to avoid the payment of tax liens, an obligation of which lenders are fully cognizant, even if the need to foreclose arises. The banks are insisting that 11 U.S.C. § 724 is applicable and that the banks (rather than the Trustee) are permitted to use this provision of the United States Bankruptcy Code to avoid the payment of the municipal tax liens, while satisfying their own expenses rather than a Trustee's. Section 724, as Judge Tuohey accurately noted in his Opinion of Distribution on Remand, *see* Appendix C, p. 25a, deals with a Trustee's lien avoidance powers, protecting certain administrative expenses and wage claims when no other source for repayment exists, and was never intended to be utilized by a mortgagee to defeat a pre-bankruptcy tax lien. By advancing such a substantial sum of money to the debtors, IBJ sought only to protect its own interests. Section 724 was never intended to reward a secured lender to the detriment of a perfected tax lienholder. In any other scenario, these taxes would have to be paid, including foreclosure or private sale. IBJ has endeavored to improve its own position, and irreparably harm the Municipalities by using a Trustee-driven statute for a perverted purpose.

In *Equibank*, the Court of Appeals for the Third Circuit considered whether the tax claims at issue were to be borne by the debtor-in-possession as a first priority administrative expense, by the estate as a seventh priority administrative expense payable from the general fund, or by the secured creditor. *Id.* at 82. The Third Circuit held that the secured creditor was responsible for payment of the real estate taxes which were secured by valid, perfected pre-petition liens from the proceeds of sale. *Id.* Although *Equibank* involved a Chapter 11 debtor, the court in *In re Parr Meadows Racing Ass'n, Inc.*, 880 F.2d 1540 (2d Cir. 1989), *cert.*

denied, 493 U.S. 1058 (1990), reached the same result in a Chapter 7 case. Section 724(b) was never intended to be used by a mortgagee to ensure the priority payment of its professional fees and mortgages over payments for legitimately incurred taxes and fees.

The same decision was reached by the Fourth Circuit in *Maryland Nat'l Bank v. Mayor & City Council of Baltimore*, 723 F.2d 1138, 1142 (4th Cir. 1983), involving a similar situation where the property was mortgaged in the amount of $6,000,000.00 and the sale was producing $2,500,000.00. In the *Maryland Nat'l Bank* decision, as in the *Equibank* decision, the court held that in a Chapter VII proceeding, "a purchaser of real property cannot avoid the consequences of a property tax lien on the purchased realty where the lien represents taxes approved before the date of sale." *Maryland Nat'l Bank*, 723 F.2d at 1142. Consequently, the arguments that these rulings do not apply to a Chapter 7 situation, or to a situation where there is a shortfall at the time of sale, are inaccurate.

The importance of this issue to the Municipalities is undeniable, as a federal statute has been given an unwarranted construction which is resulting in the loss of substantial amounts of tax revenue to two municipalities. Indeed, with regard to Rutland, the facility was one of its largest single taxpayers, representing three and one half percent of the accrued total tax revenue. This money will never be recouped by the Municipalities. No salutary purpose of the United States Bankruptcy Code is being advanced by preferring mortgagees over priority perfected municipal tax lienors. Yet, this is precisely the result of the Third Circuit's affirmance of the District Court's opinion. The consideration of this matter by the Supreme Court is essential not only to the continued vitality of the Municipalities and to remedy a conflict among the Circuits as to the interpretation of a federal statute, but to protect other governmental bodies from decisions reaching the same unwarranted result.

Simply stated, it was not the intent of Congress in enacting 11 U.S.C. § 724(b) to grant preferred status to mortgagees, particularly where such creditors have controlled and manipulated Chapter 7 bankruptcy proceedings to the detriment of other first-priority secured creditors, that is, legitimate municipal tax claimants. Any interpretation to the contrary would pervert the legislature's intent, offending the principles of equity and justice upon which the United States Bankruptcy Code is founded.

The important question as to the proper treatment of municipal tax liens needs to be resolved by this Court so that municipalities similarly situated will be guided in handling future defaults in tax payments by potential debtors. The question has great national significance and should not be resolved in a piecemeal fashion by the remaining Circuit Courts of Appeal.

II.

THE DECISIONS BELOW THAT 11 U.S.C. § 506(c) IS NOT APPLICABLE ARE A MISINTERPRETATION OF THE PURPOSE OF A FEDERAL STATUTE.

Both the courts in *Equibank, N.A. v. Wheeling-Pittsburgh Steel Corp.*, 884 F.2d 80, 86-87 (3d Cir. 1989) and *Maryland Nat'l Bank v. Mayor & City Council of Baltimore*, 723 F.2d 1138, 1144 (4th Cir. 1983) held that tax claims which had not become liens at the time of the bankruptcy filing may be payable by the secured creditor as payment for benefit received. Yet, none of the courts below found it necessary for the United States Bankruptcy Court to conduct a hearing to determine whether the post-petition taxes were reasonable and necessary expenses directly benefiting the mortgagees, IBJ, by protecting their collateral. Rutland and Bristol are entitled to payment for post-petition administrative expenses, either from the secured creditors as an 11 U.S.C. § 506(c) expense, or to share pro rata with the other administrative claimants who

have received one hundred percent payments on their administrative claims from IBJ. A bankruptcy trustee cannot be permitted to administer fully secured property which has had the benefit of all municipal services for almost two years, contrary to the provisions of the United States Bankruptcy Code, and then be permitted to eradicate the Municipalities' municipal tax claims, both pre- and post-petition.

Indeed, the Third Circuit, in a previous decision, indicated that the Bankruptcy Code provides that taxes which have not attained lien status may be payable by the secured creditor as payment for benefit received in accordance with 11 U.S.C. § 506(c). *See Equibank, N.A. v. Wheeling-Pittsburgh Steel Corp.*, 884 F.2d 80, 83 (3d Cir. 1989).

At a minimum, the Bankruptcy Court must determine whether the taxes were reasonable, necessary costs and expenses of preserving or disposing of the property, and whether they benefited IBJ. *See* 11 U.S.C. § 506(c). This was not done. The lower courts need guidance from this Court as to the proper application of this federal statute.

CONCLUSION

The City of Rutland and Town of Bristol, Vermont have demonstrated in this Petition that the Third Circuit Court of Appeals' decision rendered below conflicts with decisions rendered by the Second and Fourth Circuits as well as with another Third Circuit decision on an issue of statutory construction. Moreover, the Petitioners have shown that the issues presented by this Petition present an important federal question due to the harm which will be caused to municipalities if secured lenders are permitted to avoid municipal tax liens simply as a consequence of the bankruptcy of a borrower. Therefore, the City of Rutland and Town of Bristol, Vermont request that their Petition for a Writ of Certiorari to the Third Circuit Court of Appeals be granted.

Respectfully submitted,

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APPENDIX A — OPINION OF THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF NEW JERSEY, FILED APRIL 5, 1991

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In the Matter of:

VICON RECOVERY SYSTEMS, INC., et al.,
Debtors.

Chapter 7

Case No. 88-05550 - 88-00554

OPINION

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Newark, New Jersey 07102-5497
By: Frank J. Vecchione, Esquire

Appendix A

-end-

White & Case
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By: Howard S. Beltzer, Esquire

TUOHEY, JUDGE WILLIAM F.

This case comes before the court on motion of the Towns of Rutland and Bristol, Vermont, to allocate and distribute proceeds of the sale of the debtors' improved and unimproved real estate and personal property, and objections to the motion filed by the creditor holding the purported first liens on the real and personal property. Both the towns and the creditor assert they have liens paramount to that claimed by the other, and request the court to enter its order allocating and distributing the proceeds accordingly.

This is a core proceeding relating to distribution of property of the estate and estate administration under 28 U.S.C.§1334 and 157(b)(2)(A, K, and O). This opinion constitutes the court's findings of fact and conclusions of law, issued pursuant to Fed.R.Civ.P. 52 and Bankruptcy Rule 7052.

FACTS

The debtor corporations were originally created to own and operate a recycling facility in Vermont. The physical plant is

located on real property in the towns of Rutland and Bristol, Vermont.

The debtors financed the purchase of the real estate, as well as the building of the physical plant, and limited operations conducted prior to filing the petition for relief in this case, through loans obtained from the Industrial Bank of Japan, Ltd. and from Industrial Bank of Japan Trust Company (collectively, IBJ). The file reveals the petitions in this case were filed shortly after the plant went on line, and that operations ceased about that same time. The petition for relief was filed August 23, 1988.

According to the record of the argument on this motion, IBJ has advanced approximately $37,000,000 in this case, and the property of the debtors, real and personal, was worth around $23,000,000 on the filing date. By earlier order of this court, after extensive sale efforts by the trustee, a sale of the property by the trustee to Meridan Group, Inc. was approved for a purchase price of $2,800,000, more or less (Order dated July 9, 1990), the highest purchase price offered. This sale was approved over the objections of the Towns of Rutland and Bristol, Vermont.

The distribution of the proceeds of sale now comes before the court. The towns seek payment of real and personal property taxes, evidenced by liens, which were levied on the improved real estate and personalty therein both pre- and post-petition, together with interest and penalties due thereon. It is IBJ's position that it is not responsible for those taxes and all funds should be transferred to IBJ as the first priority secured creditor. Further, IBJ asserts these tax liens are avoidable by the trustee and/or unperfected, and so should be subordinated to its claim.

The parties have stipulated to the amounts of taxes due, as follows:

Appendix A

	Bristol	Rutland
Pre-petition tax		
Real	8,645.00	485,938.43
Personal	1,025.05	183,022.37
Post-petition tax		
Real	16,311.99	303,611.27
Personal	942.88	196,848.11
Penalties, Interest & Fees, Pre-petition	3,674.68	209,431.63
Penalties, Interest & Fees, Post-petition	1,785.33	67,069.22

DISCUSSION

In order to decide the issues raised in the motion and objection, it is necessary to examine the Vermont laws giving rise to the taxes here sought and creating the tax liens. *Butner v. United States*, 99 S.Ct. 914, 440 U.S. 48 (1979). As to real estate taxes, assessments are determined according to the appropriate levy, and a "grand list" is prepared which is filed with the town clerk. The taxes become a first lien on the real estate, and notice of the creation of the lien must be given "to all parties in interest having an interest in such land," 32 V.S.A. § 5061(b) (1989). The lien may not, however, be foreclosed upon until the taxes secured by it have remained unpaid for a period of at least two years. 32 V.S.A. § 5061(b) (1989). The filing of the grand list is a prerequisite to creation of the tax lien. *West v. Village of Morrisville*, 563 F. Supp. 1101 (D.Vt. 1983), *vacated on other grounds* 728 F.2d 130 (2nd Cir. 1984). Personal property taxes are assessed by the towns' tax

collectors, who then may file a notice of tax lien with the town clerk. Notice of the tax lien may not be filed prior to April 1 of the year following the tax assessment, but, if such notice is filed, *must* be given to the taxpayer, property owner (if not the taxpayer), and to lienholders. 32 V.S.A. § 5071 (1989). The lien is created by the filing of the notice and is effective for two years against all but bona fide purchasers without notice of the lien. 32 V.S.A. 5072 (1989); *In re Cummings Market, Inc.*, 53 B.R. 224 (Bankr.D.Vt. 1985).

As previously stated, the parties have stipulated the amounts of the taxes due pre-petition, and the penalties, interest, and fees on those pre-petition taxes. There is no indication in that stipulation that charges are assessed differently on the tax depending upon which type of tax is under consideration.

It is clear from reading these statutes that the liens become perfected first liens upon filing notices of taxes assessed with the town clerk. The grand lists (tax assessment notices) were last filed on pre-petition tax amounts on June 24, 1988 in Bristol, and on July 22, 1988 in Rutland. (Motion of Towns, Exhibits B and C). Therefore, when the petitions for relief were filed in these consolidated cases on August 10, 1988, both towns had perfected and valid first liens on the property for the amounts of the taxes. *In re Cummings Market, Inc., supra; In re New England Carpet Co., Inc.*, 26 B.R. 934 (Bankr.D.Vt. 1983).

These liens remain attached to property and survive filing of the petitions for relief. *Equibank, N.A. v. Wheeling-Pittsburgh Steel Corp.*, 884 F.2d 80 (3rd Cir. 1989); *Matter of Isley*, 104 B.R. 673 (Bankr.D.N.J. 1989). These liens are treated as any other secured interest on property under 11 U.S.C. 506(b), and interest accrued upon them both pre- and post-petition is recoverable by

the towns at the rates stipulated by the parties. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 109 S.Ct. 1026, 103 L.Ed.2d (1989); *Matter of Isley, supra.*

As to the post-petition amounts, none of the assessments were made, nor notices filed, prior to the filing date. The automatic stay provisions of 11 U.S.C. § 362 prevented creation of liens for the post-petition taxes, and these amounts (together with penalties, interest, and fees due thereon) from becoming liens or attaining status greater than that accorded other administrative claims. As a practical matter, there will be no funds available for payment of administrative claims since IBJ holds grossly undersecured claims which will exhaust the funds remaining in the estate. Under 11 U.S.C. §§ 506 and 724, IBJ must, of course, next be paid, so characterization of the tax liens as either first or seventh administrative priority is unnecessary. *In re Darnell*, 834 F.2d 1263 (6th Cir. 1987).

The parties have, however, strenuously argued the issue of administrative priority, so the court will briefly address the issue. Seventh priority administrative claims include

> a property tax assessed before the commencement of the case and last payable without penalty after one year before the date of the filing of the petition; . . .

11 U.S.C. § 507(a)(7)(B). Since none of the post-petition taxes were assessed "before the commencement of the case," none of the post-petition taxes can be a seventh priority administrative claim.

First priority administrative claims are enumerated by reference to 11 U.S.C. § 503(b), which accords administrative priority to

> any tax —
>
> (i) incurred by the estate, except a tax of a kind specified in section 507(a)(7) of this title; . . .

11 U.S.C. § 503(b)(1)(B). Post-petition property taxes are payable as first priority administrative expenses under the plain language of the statute when a request for payment is filed. *In re Spruill*, 78 B.R. 766 (Bankr.E.D.N.C. 1987). The interest on these claims is also accorded first priority administrative status. *Matter of Isley, supra.* Thus, were the funds available, the post-petition taxes, penalties, fees, and interest would be accorded this priority.

In conclusion, the court finds and concludes that the Towns of Bristol and Rutland hold secured tax liens for the amounts of taxes assessed and perfected by filing notices of assessment pre-petition, and are entitled to receive interest, penalties, and fees on those amounts. All other amounts claimed due by the towns are accorded first priority administrative status, which amounts include all post-petition taxes and the penalties, interest, and fees due thereon. IBJ is, however, under 11 U.S.C. §§ 506 and 724 entitled to be paid prior to payment of any administrative claims.

WILLIAM F. TUOHEY
U.S. Bankruptcy Judge

Dated: April 5, 1991
Newark, New Jersey

APPENDIX B — ORDER OF THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF NEW JERSEY, FILED APRIL 5, 1991

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In the Matter of:

VICON RECOVERY SYSTEMS, INC., et al.,

Debtors.

Chapter 7

Case No. 88-05550 - 88-00554

ORDER GRANTING MOTION OF TOWNS OF BRISTOL AND RUTLAND, VERMONT DETERMINING ALLOCATION AND DISTRIBUTION OF PROCEEDS OF SALE, ETC.

This matter having come before the court on motion of the Towns of Rutland and Bristol, Vermont, to allocate and distribute proceeds of the sale of the debtors' improved and unimproved real estate and personal property, and upon the objections to said motion filed by the Industrial Bank of Japan, Ltd.; and the court having rendered its findings of fact and conclusions of law in an opinion rendered this date incorporated herein by reference;

IT IS, on this 5th day of April, 1991;

ORDERED, that the Towns of Bristol and Rutland hold secured tax liens for the amounts of taxes assessed and perfected by filing notices of assessment pre-petition, and said towns are

entitled to receive interest, penalties, and fees on those amounts. All other amounts claimed due by the towns are accorded first priority administrative status, which amounts include all post-petition taxes and the penalties, interest, and fees due thereon. IBJ is, however, under 11 U.S.C. §§ 506 and 724 entitled to be paid prior to payment of any administrative claims.

s/ William F. Tuohey
U.S. Bankruptcy Judge

APPENDIX C — OPINION OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY, FILED NOVEMBER 26, 1991

NOT FOR PUBLICATION

UNITED STATES DISTRICT COURT
DISTRICT OF NEW JERSEY

Civil Action
Nos. 91-3402 (MTB)
91-3403 (MTB)

In the Matter of:

VICON RECOVERY SYSTEMS, INC. a/k/a VICON RECOVERY SYSTEMS, INC. OF VERMONT, VICON RECOVERY SYSTEMS OF MANCHESTER, INC., VICON RECOVERY SYSTEMS OF MASSACHUSETTS, INC., VICON RECOVERY SYSTEMS OF VERMONT, INC., VICON RECOVERY SYSTEMS OF WEBSTER, INC.,

Debtors.

THE INDUSTRIAL BANK OF JAPAN, LTD., NEW YORK BRANCH and THE INDUSTRIAL BANK OF JAPAN TRUST COMPANY,

Appellants,

v.

TOWNS OF BRISTOL AND RUTLAND, VERMONT,

Appellees.

Appendix C

TOWNS OF BRISTOL AND RUTLAND, VERMONT,
Cross-Appellants,

v.

THE INDUSTRIAL BANK OF JAPAN, LTD., NEW YORK BRANCH and THE INDUSTRIAL BANK OF JAPAN TRUST COMPANY,
Cross-Appellees.

OPINION

BARRY, District Judge

I. INTRODUCTION

This is an appeal and cross-appeal of the bankruptcy court's order dated April 5, 1991 distributing the $2,880,000 in proceeds of the sale of substantially all the property of the debtors' estates. The towns of Bristol and Rutland, Vermont (the "Towns") sought payment of real and personal property taxes, together with interest and penalties, that were assessed pre-petition and post-petition against the real estate and personalty of the property that is the subject of this dispute. The key question before the court, because the proceeds are substantially less than the aggregate claims, is whether the Towns' real property tax lien, regardless of perfection, should be subordinated to the administrative expense claims of the Industrial Bank of Japan, Limited, New York Branch and the Industrial Bank of Japan Trust Company (collectively "IBJ") under § 724(b)(2) of the Bankruptcy Code, 11 U.S.C. § 101, *et seq.*

The Honorable William F. Tuohey, in an Opinion filed April 5, 1991, held that the Towns had prior liens for taxes "assessed and perfected by filing notices of assessment pre-petition, and are entitled to receive interest, penalties, and fees on those amounts." (Op. at 8) IBJ claims - correctly - that the bankruptcy court failed to consider § 724(b)(2) of the Bankruptcy Code which specifically

sets forth the proper distribution of proceeds in a Chapter 7 case when there are competing claims between a taxing authority and an administrative claimant. Judge Tuohey also held that the post-petition tax claims and unperfected pre-petition tax claims of the Towns are not entitled to be paid prior to the liens of IBJ. For the reasons that follow, the decision of the bankruptcy court is reversed in part, affirmed in part, and remanded for proceedings consistent with this opinion.

II. FACTS

On August 23, 1988, the debtor corporations filed a petition for relief under Chapter 7 of the Bankruptcy Code. The debtors owned and operated a recycling facility located in the towns of Rutland and Bristol, Vermont. The real property on which the facility is situated was purchased and subsidized by IBJ to the tune of approximately $37,000,000, although the real and personal property is worth far less. By order of the bankruptcy court dated July 9, 1990, the trustee sold the property to the Meridan Group, Inc. for approximately $2,800,000, an amount, as noted earlier, which is less than the total claims of IBJ and the Towns. This sale was subject to a further hearing, held on August 14, 1990, on the relative priority of the Towns' tax liens and IBJ's administrative expense claims. On April 5, 1991 the bankruptcy court distributed the proceeds in accordance with the court's finding that the tax liens should be given priority. These appeals followed.

III. Discussion

A. Pre-Petition Realty Taxes and Section 724(b)

The Towns contend, and the bankruptcy court agreed, that the pre-petition tax claims are secured by valid, perfected liens under Vermont law and, thus, are entitled to priority payment over the

administrative expense claims of IBJ. IBJ, however, contends that even assuming that the Towns have prior perfected liens, it nevertheless is entitled to priority distribution under § 724(b)(2) because that provision specifically subordinates tax liens to administrative expenses. It is apparent from the bankruptcy court's Opinion that, in determining the order of distribution, the court did not consider the effect of § 724(b)(2), but, rather, analyzed the distribution scheme under state priority laws, Chapter 11 case authority, and §§ 506 and 507.[1] Upon a *de novo* review of the applicable case law, I agree with IBJ that § 724(b)(2) governs the distribution of the pertinent proceeds, and find that the Towns' tax liens, even if perfected, are subordinated to administrative expenses.

The language of § 724(b) clearly frames the analysis when a Chapter 7 case, as this, has at issue property encumbered by a tax lien. Section 724(b) states in part:

> Property in which the estate has an interest and that is subject to a lien that is not avoidable under this title and that secures an allowed claim for tax, or proceeds for such property, shall be distributed -
>
> > (1) first, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is senior to *such* tax lien;

---

1. To the extent that the bankruptcy court addressed § 724, it addressed only § 724(b)(1), and that implicitly. *See infra*.

> (2) second, to any holder of a claim of a kind specified in section [507(a)(1)-(6), administrative claims] . . . to the extent of the amount of such allowed tax claim that is secured by such tax lien;
>
> (3) third, *to the holder of such tax lien,* to any extent that such holder's allowed tax claim that is secured by such tax lien exceeds any amount distributed under paragraph (2) of this subsection;

11 U.S.C. § 724(b) (emphasis added).

Any doubt as to the purpose and effect of § 724(b) is dispelled by the legislative history. Section 724(b), which is derived from section 67c(3) of the Bankruptcy Act, "subordinates tax liens to administrative expense and wage claims . . ." H.R. Rep. No. 595, 95th Cong., 1st Sess. 382 (1978), *reprinted in* 1978 U.S.Code Cong. & Admin.News 5787, 6338. "In other words, the priority claimants step into the shoes of the tax collector." *Id. See also* 4 *Collier on Bankruptcy* (15th ed. 1989) ¶ 724.03 at 724-25 ("The effect of section 724(b) is to treat a tax lien as a claim ahead of the priority for taxes (now section 507(a)(7)) and after the other priorities under section 507(a) rather than as a secured claim.")

Application of § 724(b) to the case at bar is straightforward. The property in which the estate has an interest is subject to a non-avoidable tax lien.[2] The proceeds subject to the tax lien, therefore,

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2. The Towns argue that § 724 is inapplicable by its very terms because the estate has no interest in the proceeds as the estate had no equity in the property at the time of the Chapter 7 filing and, thus, because the value of the property to the estate was exceeded

(Cont'd)

must first be distributed according to § 724(b)(l) to any holder of a claim senior *to the tax claim*. Section 724(b)(1) is inapplicable here because, assuming that IBJ's claim is not "senior" to the tax lien under state law, IBJ is nonetheless entitled to payment next after any claimholder senior to the tax lien. Because, however, § 724(b)(1) is apparently the source of some confusion in this case, it will briefly be explored. In the Towns' supplemental memorandum of law submitted to the bankruptcy court, the Towns focused solely on the applicability of § 724(b)(1), not § 724(b)(2). (Exh. b, Docket Entry 324, at 7-9) Even assuming, as the Towns argued, that under Vermont law and the facts of this case the Towns' tax lien is given priority over IBJ's claim, the tax lien must still be subordinated. While it is true, as the Towns suggest, that Congress did not intend to alter priority distribution under non-bankruptcy law, Congress clearly intended to change the effect of tax liens vis-a-vis administrative expenses.

In *Pearlstein v. U.S. Small Business Administration*, 719 F.2d 1169 (D.C. Cir. 1983), the court held that a later perfected tax lien was senior to an SBA lien under nonbankruptcy law, pursuant to § 724(b)(1). The *Pearlstein* court noted:

> The statute does not define whether a lien "is senior to such tax lien" (subsection (1)) or "is junior to such tax lien" (subsection (4)), or state upon what basis the determination of

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(Cont'd)

by the tax liens and secured claims, the property should have been abandoned by IBJ. This argument fails because, aside from the fact that § 724 only applies to Chapter 7 petitions (which frequently involve fully encumbered property), abandonment of the property would be improper. In *In re K.C. Machine & Tool Co.*, 816 F.2d 238 (6th Cir. 1987), the Sixth Circuit held that abandonment is inappropriate notwithstanding a lack of equity in the property when the provisions of § 724(b) allow for satisfaction of administrative expenses.

> those priorities shall be made. There is no indication that when Congress in section 724(b) restructured and restated the provisions covering distribution of property in the estate that was subject to tax liens, it intended to change the prior settled law and practice that the relative priorities of liens in bankruptcy (including tax liens subordinated by section 67(c)(3) of the Chandler Act) were to be determined according to the non-bankruptcy lien law . . . .
>
> * * *
>
> We therefore conclude that in section 724(b)(1) Congress did not by implication define "senior" to incorporate the settled federal principle that 'the first in time is the first in right.'

Id. at 1175-76 (citation omitted). Thus, for purposes of determining whether a claim is "senior" or "junior" to a tax lien, one must look to the applicable state nonbankruptcy law. This simply leaves "senior and junior lienors and holders of unsecured claims undisturbed" by permitting "priority claimants [to] step into the shoes of the tax collector." H.R. Rep. No. 595, 95th Cong., 1st Sess. 382 (1978), *reprinted* in 1978 U.S.Code Cong. & Admin.News 5787, 6338.

The inapplicability of section 724(b)(1) to the facts of this case means that distribution must occur according to section 724(b)(2). For example, in *In re Granite Lumber Co.*, 63 B.R. 466 (Bankr. D. Mont.1986), after determining under nonbankruptcy law that the tax liens were superior to a mortgage lien, the court stated that "[s]ince the . . . [tax] lien is superior or prior in right to the mortgage

. . . [s]ection 724(b)(1) has no application to the facts of this case. Thus, we look to 724(b)(2). . . ." *Id.* at 470.

Under § 724(b)(2), property subject to a tax lien is distributed second to any holder of a claim of a kind specified in section 507(a)(1-6), which in this case includes administrative expenses. Because IBJ has incurred administrative expenses, and Judge Tuohey has certainly not suggested that that characterization is inappropriate, the Towns' tax liens must be subordinated.[3] The bankruptcy court's ruling on the pre-petition realty taxes will be reversed.

B. *Post-Petition Tax Claims, Unperfected Pre-Petition Tax Claims and Personalty Taxes*

The Towns, as cross appellants, claim that the bankruptcy court erred in holding that at least certain of the post-petition tax claims and unperfected pre-petition tax claims are not entitled to priority payment under § 506(c). Section 506(c) states:

---

3. The Towns rely on *Equibank, N.A. v. Wheeling-Pittsburgh Steel Corp.*, 884 F.2d 80 (3d Cir. 1989), for the proposition that a secured creditor is responsible for payment of real estate taxes. While this may be true in the context of a Chapter 11 petition, it is wholly irrelevant to a Chapter 7 case such as this which deals with § 724(b). Moreover, although the Towns point out that *In re Parr Meadows Racing Association, Inc.*, 880 F.2d 1540 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 869 (1990), was a Chapter 7 case where the court held that a tax lien should be satisfied by proceeds prior to distribution to the secured creditors, there is absolutely no mention of § 724(b) in that case and there is no indication that administrative expenses were involved. Indeed, this court has not located any case in which a court determined that a taxing authority is entitled to payment prior to administrative expenses under § 724(b).

Lastly, the Towns' "equitable subordination" argument under § 510(c), aside from appearing to be an argument of last resort, was not raised before the bankruptcy court and I do not find that argument necessary to address.

Appendix C

> The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.

Such costs and expenses, argue the Towns, should be borne by IBJ as a cost of preserving their collateral.

While it is doubtful that IBJ, which is owed tens of millions of dollars, has benefitted from the sale apart from a potential payment of administrative expenses, it is clear that to the extent that the Towns are seeking their own administrative expenses they must look to § 724(b). In *In re Sherill*, 78 B.R. 804 (Bankr. W.D. Tex. 1987), the court held that "when Section 724(b) is available to enable a Chapter 7 trustee to recover his administrative expenses and costs of sale, the trustee must look to that fund for payment. If he fails to do so, Section 506(c) will not be available as a substitute to 'back and fill.' " *Id.* at 807. Thus, even assuming that section 506(c) applies apart from the Trustee, the Towns must seek recovery of administrative expenses pursuant to § 724(b). Indeed, in the Towns' memorandum of law they acknowledge that if this court decides that § 724(b) is applicable, "the Towns" would obviously be entitled to collect their pro rata share as an administrative expense claim under that section." (Town Br. at 13) The bankruptcy court's decision not to charge IBJ with the Towns' administrative claims under § 506(c) will be affirmed.

The last point of contention raised by IBJ concerns the Towns' personalty tax liens, a point which, given the disposition herein, is of little or no moment. IBJ argues that the bankruptcy court did not directly rule upon the personalty tax issue when it held that taxes "assessed and perfected by filing notices of assessment pre-

petition" were entitled to payment. IBJ invokes Vermont law, 32 V.S.A. § 5071 (1989), which governs "notice" of tax liens. The Towns conceded before Judge Tuohey that they failed to give proper notice of the personalty taxes and have not suggested anything to the contrary to this court. (Item 12, Aug. 1990 Tr., at 5-6). Upon remand, the bankruptcy court can decide the personalty tax issue, if any there be and if there be a need to do so.

This case is remanded to the bankruptcy court for the purpose of distributing the proceeds in accordance with this opinion. An appropriate order shall issue.

s/ Maryanne Trump Barry
MARYANNE TRUMP BARRY
U.S.D.J.

Dated: November 25, 1991

APPENDIX D — ORDER OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEW JERSEY, FILED NOVEMBER 26, 1991

Civil Action
Nos. 91-3402 (MTB)
91-3403 (MTB)

In the Matter of:

VICON RECOVERY SYSTEMS, INC., a/k/a VICON RECOVERY SYSTEMS, INC. OF VERMONT, VICON RECOVERY SYSTEMS OF MANCHESTER, INC., VICON RECOVERY SYSTEMS OF MASSACHUSETTS, INC., VICON RECOVERY SYSTEMS OF VERMONT, INC., VICON RECOVERY SYSTEMS OF WEBSTER, INC.,

Debtors.

THE INDUSTRIAL BANK OF JAPAN, LTD., NEW YORK BRANCH and THE INDUSTRIAL BANK OF JAPAN TRUST COMPANY,

Appellants,

v.

TOWNS OF BRISTOL AND RUTLAND, VERMONT,

Appellees.

Appendix D

TOWNS OF BRISTOL AND RUTLAND, VERMONT,

Cross-Appellants,

v.

THE INDUSTRIAL BANK OF JAPAN, LTD., NEW YORK BRANCH AND THE INDUSTRIAL BANK OF JAPAN TRUST COMPANY,

Cross-Appellees.

ORDER

This matter having come before the court on the appeal of the Industrial Bank of Japan ("IBJ") and the cross-appeal of the towns of Bristol and Rutland, Vermont ("the Towns") from the Opinion and Order of the Honorable William F. Tuohey of the Bankruptcy Court filed April 5, 1991 pursuant to 28 U.S.C. § 158(a); and

For the reasons expressed in this court's Opinion dated November 25th, 1991;

IT IS on this 25th day of November, 1991

ORDERED that the Opinion and Order of the Honorable William F. Tuohey filed April 5, 1991 is hereby reversed in part, affirmed in part, and remanded for the reasons expressed in this court's Opinion.

s/ Maryanne Trump Barry
U.S.D.J.

APPENDIX E — OPINION AND ORDER OF DISTRIBUTION ON REMAND OF THE UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF NEW JERSEY, FILED MARCH 5, 1992

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

In the Matter of:

VICON RECOVERY SYSTEMS, INC., et al.,
Debtors.

Chapter 7

Case No. 88-05550 - 88-00554
Hearing: January 13, 1992

OPINION AND ORDER OF DISTRIBUTION ON REMAND

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Appendix E

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TUOHEY, JUDGE WILLIAM F.

This court having entered an order and opinion on or about April 5, 1991, granting a motion brought before the court by the Towns of Bristol and Rutland, Vermont, determining the allocation and distribution of certain proceeds of sale in the above chapter 7 estate; and the Industrial Bank of Japan Trust Company ("IBJ") having filed an appeal from said order; and the United States District Court for the District of New Jersey, Honorable Maryanne Trump Barry, U.S.D.J., having issued an order and opinion on November 25, 1991, affirming the order of the bankruptcy court in part and reversing in part, and further remanding the case to the bankruptcy court for purposes of distributing the aforementioned proceeds of sale in accordance with the district court order; and this court having conducted a hearing on remand on January 13, 1992, based upon the papers submitted by the parties as well as oral

argument at said remand; and further based upon the opinion entered by the district court, the court makes the following findings on remand.

1. The debtors pre-bankruptcy operated a resource-recovery and recycling plant. IBJ funded the construction of the plant to the extent of $37 million dollars. At the filing of the bankruptcy, debtors alleged their real and personal property had a value of $23 million. The case was filed as a chapter 7, and the plant was closed. The trustee, with the consent of IBJ "mothballed" the plant and kept guards and technicians at the plant who maintained and preserved the machinery and equipment. Attempts were made by IBJ and the trustee to sell the plant from the date of filing, August 23, 1988, until July 9, 1990. All attempts to sell failed with the exception of the final offer of the Meridian Group, whose purchase price of $2.8 million was approved by the court. During the two year period that IBJ tried to sell the plant, it advanced $1,186,563.78 to preserve the plant and pay the trustee and his professionals.

2. In the opinion and order entered April 5, 1991, the bankruptcy court held that the Towns of Bristol and Rutland, Vermont, held perfected, secured tax liens for taxes assessed by filing notices of assessment pre-petition in conformance with Vermont state law, and were entitled to be paid such taxes, as well as interest, penalties and fees thereon. The bankruptcy court further held that all post-petition taxes, claimed by the said Towns, including interest, penalties and fees thereon were administrative claims which were not entitled to be paid prior to satisfaction of IBJ's liens.

3. Pursuant to the April 5, 1991 order of the bankruptcy court, the chapter 7 trustee paid the sum of $703,536.77 to Rutland,

Vermont; and the sum of $13,356.60 to Bristol, for a total payment by the trustee to the aforesaid municipalities of $716,893 .37 .

4. The district court ruled that perfected, pre-petition tax liens of the Towns are subordinated to the payment of administrative claims pursuant to Bankruptcy Code 724(b)(2). The district court, in reversing the bankruptcy court, found that Code section 724, which deals with the trustee's lien avoidance powers and protects certain administrative expenses and wage claims, may be used by a mortgagee to defeat a pre-bankruptcy tax lien. The court notes the mortgagee funded the chapter 7 for two years while marketing the debtor's property. The district court also affirmed the bankruptcy court's finding as to the Towns' post-petition tax claims holding that such claims are subordinate to IBJ's liens and could not be charged to IBJ under 506(c) of the Bankruptcy Code.

5. On January 28, 1991, the parties filed a stipulation as to certain facts. Said stipulation fixes the pre-petition real property taxes due and owing to Rutland and Bristol at the following sums:

Bristol, Vermont	$8,645.00
Rutland, Vermont	485,938.43
	$494,583.43

6. Using the analysis of the district court and implementing Bankruptcy Code § 724(b)(2), the court concludes that the amount to be distributed to administrative claimants pursuant to said Code section is $494,583.43. Said amount is equal to the pre-petition, real estate taxes of the two municipalities.

7. The administrative claimants entitled to share in this fund are IBJ and the two municipalities. Their respective claims being $1,186,563.78 and $688,819.61. Pursuant to the decision of the

district court, the pre-petition real estate tax claims, namely $494,583.43, are used to compute the funds for the prorated payment of the allowed, administrative claims of IBJ and the municipalities pursuant to Bankruptcy Code § 724(b)(2).

8. The penalties, interest and fees on such taxes, substantially all of which accrued post-petition, do not constitute part of the 724 fund, because the district court held that tax liens are treated as seventh priority, unsecured claims rather than secured claims in chapter 7 proceedings by virtue of § 724(b).

9. The administrative claim of the municipalities is determined to be $688,819.61. This sum includes $179,376.42 in penalties, interest and fees as set forth in the municipalities' letter of January 28, 1992. Thus, the total of the administrative claims is the total of $1,186,563.78 plus $688,819.61, for a total administrative claim of $1,875,383.39. IBJ's administrative claim thus constitutes 63.27% of such total and IBJ is thus entitled to 63.27% of the § 724 fund of $494,583.43. The municipalities' administrative claim constitutes 36.73% of said total, and the Towns are therefore entitled to 36.73% of the aforesaid 724 fund.

Applying the aforesaid ratios to the Code § 724 fund referred to by the district court, we have an administrative distribution to the International Bank of Japan in the amount of $312,992.94 and to the municipalities of $181,660.49, for a total distribution of $494,583.43.

IBJ is entitled to the remainder of all the property of the estate.

The Towns shall, within sixty (60) days, turn over to IBJ the sums constituting the differential between the amount awarded

herein and the amounts paid by the trustee to the municipalities.

s/ William F. Tuohey
U.S. Bankruptcy Judge

DATED: March 5, 1992
Newark, New Jersey

APPENDIX F — JUDGMENT ORDER OF THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT, FILED AUGUST 6, 1992

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT
No. 91-6036

VICON RECOVERY SYSTEMS, INC., A/K/A VICON RECOVERY SYSTEMS, INC. OF VERMONT; VICON RECOVERY SYSTEMS OF MANCHESTER, INC.; VICON RECOVERY SYSTEMS OF VERMONT, INC.; VICON RECOVERY SYSTEMS OF WEBSTER, INC.,

Debtors.

THE INDUSTRIAL BANK OF JAPAN, LIMITED, New York Branch; THE INDUSTRIAL BANK OF JAPAN TRUST COMPANY,

v.

JONATHAN KOHN, Trustee; TOWN OF RUTLAND, VERMONT; TOWN OF BRISTOL, VERMONT.

(Newark, New Jersey District Civil No. 91-03402)

VICON RECOVERY SYSTEMS, INC., A/K/A VICON RECOVERY SYSTEMS, INC. OF VERMONT; VICON RECOVERY SYSTEMS OF MANCHESTER, INC.; VICON RECOVERY SYSTEMS OF MASSACHUSETTS, INC.; VICON RECOVERY SYSTEMS OF WEBSTER, INC.,

Debtors.

Appendix F

TOWN OF RUTLAND, VERMONT;
TOWN OF BRISTOL, VERMONT,

v.

JONATHAN KOHN, Trustee;
THE INDUSTRIAL BANK OF JAPAN, LIMITED, New York Branch; and THE INDUSTRIAL BANK OF JAPAN TRUST COMPANY
(BK CT CASE NO. 88-05550, 05551, 05552, 05553, 05554)

(Newark, New Jersey District Civil No. 91-03403)

Towns of Rutland and Bristol, Vermont,

Appellants.

Appeal from the United States District Court
for the District of New Jersey
District Judge: Honorable Maryanne Trump Barry

Submitted Under Third Circuit Rule 12(6)
July 28, 1992
Before: BECKER, MANSMANN and NYGAARD,
Circuit Judges

JUDGMENT ORDER

After consideration of all contentions raised by the appellants, and essentially for the reasons set forth in the district court opinion

by the Honorable Maryanne Trump Barry dated November 25, 1991; it is

ADJUDGED and ORDERED that the judgment of the district court be and is hereby affirmed.

Costs taxed against the appellants.

BY THE COURT,

s/ Carol Los Mansmann
Circuit Judge

Attest:
s/ Sally Mrvos,
Clerk

AUG 6, 1992

Appendix F

No. 91-6036

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Costs taxed in favor of The Industrial Bank of Japan, Limited, New York Branch; The Industrial Bank of Japan Trust Company as follows:

Total for Brief	$180.50
Total	$180.50

Certified as a true copy and issued in lieu of a formal mandate on August 28, 1992.

Test: s/ Sally Mrvos

Clerk, U.S. Court of Appeals for the Third Circuit.